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IN THE

Supreme Court of the United States

NO. 498

CENTRAL TRUST COMPANY OF NEW YORK,
Plaintiff,

v.

THE PITTSBURG, SHAWMUT AND NORTHERN RAILROAD COMPANY, SHAWMUT MINING COMPANY, THE KERSEY MINING COMPANY and HAMILTON TRUST COMPANY, Defendants.

ROBERT WOMSLEY, CHARLES A. WOODS, JR., and KENNETH BALLENTYNE, Constituting a Committee for the Protection of Holders of Certificates of Indebtedness of the Receiver of The Pittsburg, Shawmut and Northern Railroad Company and the Mortgaged Properties of the Shawmut Mining Company and The Kersey Mining Company; HUGO E. SELLGER; EDWARD L. BLACKMAN and PFLUGFELDER, BAMPTON & RUST, a Partnership, Individual Holders of Some of Such Certificates, Petitioners.

PETITION FOR REVIEW ON WRIT OF CERTIORARI OF A JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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PETITION FOR REVIEW ON WRIT OF CERTIORARI OF A JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable Fred M. Vinson, Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

ROBERT WOMSLEY, CHARLES A. WOODS, JR., and KENNETH BALLENTYNE, constituting a Committee for the Protection of Holders of Certificates of Indebtedness of the Receiver of The Pittsburg, Shawmut and Northern Railroad Company and the Mortgaged Properties of the

Shawmut Mining Company and The Kersey Mining Company; HUGO E. SELLGER; EDWARD L. BLACKMAN and PFLUGFELDER, BAMPTON & RUST, a Partnership, Individual Holders of some of such Certificates, Petitioners, respectfully petition for review on writ of certiorari of a judgment of the United States Court of Appeals for the Third Circuit entered September 29, 1949, on which rehearing was denied October 26, 1949, affirming an order of the District Court of the United States for the Western District of Pennsylvania, entered November 9, 1948.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

(a) The Proceedings Below

The District Court did not file an opinion. The opinion of the Court of Appeals is officially reported at 176 F. 2d 937.

(b) The Facts of the Case

Review is sought of a judgment of the United States Court of Appeals for the Third Circuit affirming a final order of the District Court of the United States for the Western District of Pennsylvania, establishing priorities as between creditors of a receiver of a railroad whose claims consisted of (1) unpaid expenses of operation of the railroad incurred by the receiver during the course of the receivership and (2) the principal of and interest on certificates of indebtedness issued and sold by such receiver pursuant to orders of the receivership court to raise funds necessary to keep the railroad in operation.

The receivership commenced in 1905. Successive receivers operated the railroad until the Spring of 1947,

when the railroad was sold. Administrative costs, such as court costs, receivers' fees, fees of their attorneys, etc., and unpaid operating expenses incurred by the present receivers to which no exceptions were filed, have been paid in full out of the proceeds of such sale. The balance of such proceeds now constitutes the fund available for distribution. The allowed claims of the remaining creditors of the receiver, described in the preceding paragraph, exceed the amount of such fund. Holders of mortgage bonds of the railroad and its equity securities will receive nothing since the estate is insolvent as to the receiver's creditors alone.

By a series of orders entered during the course of the receivership, the District Court authorized the receiver to issue and sell certificates of indebtedness, hereinafter referred to as the "certificates", until at August 1, 1910, there had been issued and were outstanding certificates in the aggregate face amount of $3,100,000.00. Substantially all of the proceeds of such certificates were, pursuant to orders of the District Court, expended by the receiver for capital improvements, equipment, rehabilitation of the railroad and similar capital items without which, as the Appellate Division of the Supreme Court of New York in *Weaver v. Pacific Improvement Company,* 198 App. Div. 825, 191 N. Y. Supp. 3, said "the road could not have been kept running."

Thereafter, by a series of refunding and reissue orders, the aggregate face amount of the issued and outstanding certificates was reduced until a final order, entered June 16, 1927, brought the amount of the outstanding certificates down to its present size of $2,044,350. Of these, $112,290 in principal amount are

held as a part of the receivership estate, and the balance of $1,932,060 in principal face amount is publicly held.

The orders authorizing the various issues, refundings, and reissues of the certificates and the orders authorizing operation of the railroad and mines contained no express provisions with respect to relative priorities in case of liquidation as between claims based on ownership of the receiver's certificates and claims for payment of operating expenses incurred by the receivers.

The typical form of the orders in which the successive receivers were authorized to incur and pay expenses of operation was as follows:

> "ORDERED, that out of the funds from time to time coming into his hands *from the operation of the said railroad,* the said receiver shall pay the necessary current expenses of operating the mortgaged property and premises, and executing the trust hereby vested in him, including all taxes and assessments upon the said property." (Emphasis supplied)

The typical language used in the orders authorizing the issue, refund and reissue of certificates is in relevant part as follows:

> "* * * said certificates and each of them shall be a debt by said Receiver for the benefit, protection and preservation of the mortgaged properties of the said defendants and of the creditors and holders of the stock and bonds of said defendant Railroad Company and shall be a lien upon said mortgaged properties, railroads and franchises, coal lands, mining rights and mining plants, and the net income, receipts and profits thereof, prior to the lien of said

mortgages or deeds of trust, or any of them, theretofore created under said properties, and shall be recognized as such in any reorganization of said defendants; and in case of any sale of said mortgaged properties by judicial procedure or otherwise, said certificates, principal and interest, and each of them, shall be paid from the moneys arising from such sale prior to any payment on account of said mortgages or deeds of trust, or any of them, unless sooner paid and cancelled by said Receiver, and said certificates, and each of them, shall be and remain a lien upon said mortgaged properties prior to the lien of said mortgages or deeds of trust or any of them, until the amount thereof, principal and interest, shall be fully paid; * * *"

By the terms of the orders of the District Court authorizing their issuance, the certificates now outstanding bore interest at the rate of 6% per annum, payable June 1 and December 1, and became due and payable June 1, 1929. Such certificates were not paid at maturity although interest thereon was paid until 1932. No interest has been paid on them since December 1, 1932.

On November 29, 1945, the District Court entered its order removing the then receiver, John D. Dickson, as receiver, and appointing successor receivers. In conducting the operation of the railroad Dickson had incurred, as receiver, various debts for operating expenses, such as for merchandise, supplies, freight, car service and other railroad charges which had not been paid at the time of his removal as receiver and were not paid by his successors. Such unpaid operating expense claims aggregate $269,541.22, all of which have been

allowed. Claims were filed by public holders of certificates having a principal face amount of $1,832,020. Such claims included claims for unpaid interest which had been accrued on such certificates since December 1, 1932, in the annual amount of $109,921.20. Holders of certificates having an aggregate principal amount of $100,040 failed to file claims thereon. The receivers now in office have filed claims on behalf of such unknown holders. No claim has been or will be filed with respect to certificates in the principal amount of $112,290 which form a part of the receivership estate. All of the claims filed with respect to the certificates were allowed as to the principal of such certificates but not as to the interest.

On March 24, 1948, the District Court ordered the allowance of certain claims not here in controversy, as to which exceptions had been filed, and on April 29, 1948, directed the receivers to prepare and file a Schedule of Distribution which should provide (a) for the payment in full, but without interest, of all claims of operating expense creditors of receiver Dickson, (b) for payment of a first dividend of 25% on the principal face amount of the certificates and (c) for the suspension of payment on certain claims. A Schedule of Distribution prepared in accordance with such order was forthwith filed and on May 7, 1948, the District Court entered an order confirming *nisi* such schedule, to become final without further order unless exceptions should be filed thereto.

Within the time allowed therefor exceptions were filed to the Schedule of Distribution and to the orders of April 29 and May 7, 1948, asserting that the District Court had erred in providing for payment in full of the claims of operating expense creditors in priority to the

claims of the certificate holders; in failing to provide for division of the distributable fund pro rata among the certificate holders and the operating expense creditors including, in the case of the certificate holders, the amount of their claims for interest; in failing to allow the claims for accrued and unpaid interest on the certificates and in failing to treat the interest on the certificates in the same manner as the operating expense claims.

On November 9, 1948, the District Court dismissed such exceptions, affirmed Schedule A of the Schedule of Distribution, which related to payment of expense claims incurred in operation of the railroad in priority to the claims of the certificate holders, and directed that distribution be made in accordance with such Schedule A.

The effect of the District Court's orders authorizing payment in full of the allowed claims of such operating expense creditors was to create a preference for such claims permitting their payment in full and leaving available for distribution to the holders of certificates the balance of the fund which, however, is much less than the principal face amount of the certificates with respect to which claims had been filed and allowed.

As a result of such orders the operating expense creditors will receive 100 cents for each dollar of the face amount of their respective claims, whereas, the certificate holders will be paid with respect to each dollar of the principal of the certificates not more than 45.431 cents or with respect to the aggregate of the principal amount of and unpaid interest on the certificates not more than 24.425 cents per dollar. If the priority is denied and pro rata distribution ordered the percentage

of recovery by both operating expense creditors and the certificate holders will be substantially less than one hundred per centum but will be uniform.

JURISDICTION.

The jurisdiction of this Court is invoked under Title 28, United States Code, Section 1254, 62 Stat. 928, on the ground that the decision below was a judgment of the United States Court of Appeals for the Third Circuit in a civil case on appeal from a final decision of the District Court of the United States for the Western District of Pennsylvania. Petitioners are parties to such civil case, the petitioning committee having been permitted by order of such District Court to intervene generally in the proceeding and the individual petitioners being creditors of the receiver whose claims were filed and allowed as to the principal thereof but not as to the interest.

The judgment of the Court of Appeals affirming the order of the District Court was entered September 29, 1949, rehearing was denied October 26, 1949, and this petition was filed November 30, 1949.

THE QUESTIONS PRESENTED.

In this Federal railroad receivership the receiver's allowed debts alone exceed the fund, resulting from liquidation of the receivership estate, which is available for distribution. All administrative costs, such as, court costs, fees of the receiver, their counsel, etc., and the operating expenses incurred by the receivers now in office have been paid in full, no objections thereto having been filed. Subsequent administrative costs have not as yet been claimed but will not be contested as to their priority. The remaining debts of the receiver consist of (1) claims for unpaid operating expenses of the railroad and mines incurred by a former receiver and (2) claims for the principal of and interest on receiver's certificates issued and sold to the public by the former receiver under orders of the receivership court to procure funds necessary to continue the operation of the railroad. The District Court, after allowance of the principal of both classes of claims but disallowance of accrued interest on the receiver's certificates, ordered that the claims for unpaid operating expenses incurred by the former receiver should be first paid in full out of the fund available for distribution, thus granting to such operating expense claimants full priority over the holders of the receiver's certificates. Neither the orders authorizing operation of the railroad and the incurring of expenses in so doing nor the orders authorizing issue, sale and re-issue of the receiver's certificates contained any provision establishing relative priorities upon liquidation as between receiver's debts for operating expenses and those evidenced by receiver's certificates. Under these circumstances:

1. Did not the order granting such priority retrospectively discriminate grossly as between creditors of the receiver of equal rank?

2. Was not such order a serious violation of the established public policy that courts shall not repudiate their self-incurred obligations?

3. Did not such order directly violate the established rule of this Court that where the fund available for distribution is less than the allowed claims of equal rank against the receiver, all such claims shall share pro rata in the fund?

4. Insofar as such order approved disallowance of the interest accrued on the receiver's certificates, did not such order constitute a gross violation of the court's duty to honor its own obligations?

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT.

1. The decision of the Court below is in conflict with the decision of this Court in *Union Trust Company of New York v. Illinois Midland Railway Company,* 117 U.S. 434, 6 S. Ct. 809 (1886), which holds (a) that where a receiver's debts having priority over mortgage bonds of any railroad, may exceed the fund available for distribution, there shall be no priority or preference among such debts, but all shall stand alike; and (b) that where receiver's certificates are issued for debts contracted by the court, having jurisdiction over the parties and the subject matter, to persons who in good faith invest their money, for the benefit of the property in the possession of the court, the certificates should be paid according to their tenor?

2. The decision of the court below is in conflict with the decisions of the Circuit Court of Appeals for the Fifth Circuit in *First National Bank of Houston v. Ewing,* 103 F. 168 (1900), and of the Circuit Court of Appeals for the Eighth Circuit in *Reconstruction Finance Company v. Missouri-Kansas-Texas Railroad Company,* 122 F. 2d 326 (1941), which hold that, in the absence of special equities justifying different treatment, receiver's debts for operating expenses and on receiver's certificates are entitled to share pro rata in the fund available for distribution where such fund is insufficient to pay all of the receiver's debts in full.

3. The decision of the court below sanctions a gross abuse of judicial power by the District Court in its repudiation of self-incurred obligations which it authorized to be issued and sold to the public, backed by

the District Court's most solemn judicial assurance as to their priority over existing mortgages and without provision in any then existing orders as to relative priorities among the receiver's debts in case, upon liquidation, the fund available for distribution should prove to be insufficient to pay in full all of the receiver's debts. Such departure from the accepted and usual course of judicial proceedings calls strongly for an exercise of this Court's power of supervision.

Respectfully submitted,

ROBERT WOMSLEY, CHARLES A. WOODS, JR., and KENNETH BALLENTYNE, Constituting a Committee for the Protection of Holders of Certificates of Indebtedness of the Receiver of The Pittsburg, Shawmut and Northern Railroad Company and the Mortgaged Properties of the Shawmut Mining Company and The Kersey Mining Company; HUGO E. SELLGER; EDWARD L. BLACKMAN and PFLUGFELDER, BAMPTON & RUST, a Partnership, Individual Holders of Some of Such Certificates,

Petitioners.

By EARL F. REED,
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BRIEF IN SUPPORT OF PETITION FOR REVIEW ON WRIT OF CERTIORARI OF A JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

OPINIONS BELOW.

The District Court did not file an opinion. The opinion of the Court of Appeals is officially reported at 176 F. 2d 937.

JURISDICTION.

The jurisdiction of this Court is invoked under Title 28, United States Code, Section 1254, 62 Stat. 928, on the ground that the decision below was a judgment of the United States Court of Appeals for the Third Circuit in a civil case (a railroad equity receivership) on appeal from a final decision of the District Court of the United States for the Western District of Pennsylvania therein. Petitioners are parties to such civil case, the petitioning committee having been permitted by order of such District Court to intervene generally in the proceeding and the individual petitioners being creditors of the receiver whose claims were filed and allowed as to the principal thereof but not as to the interest.

The judgment of the Court of Appeals affirming the order of the District Court was entered September 29, 1949, rehearing was denied October 26, 1949, and this petition was filed November 30, 1949.

STATEMENT OF THE CASE.

Review is sought of a judgment of the United States Court of Appeals for the Third Circuit affirming a final order of the District Court of the United States for the Western District of Pennsylvania (R. 89a, 90a), establishing priorities as between creditors of a receiver of a railroad in a Federal equity receivership whose claims consisted of (1) unpaid expenses of operation of the railroad incurred by the receiver during the course of the receivership and (2) the principal of and interest on certificates of indebtedness issued and sold by such receiver pursuant to orders of the receivership court to raise funds necessary to keep the railroad in operation.

The receivership commenced in 1905. (R. 1a, 13b-17b) Successive receivers operated the railroad until the Spring of 1947, when the railroad was sold. Administrative costs, such as court costs, receivers' fees, fees of their attorneys, etc., and unpaid operating expenses incurred by the present receivers to which no exceptions were filed, have been paid in full out of the proceeds of such sale (R. 21b). The balance of such proceeds now constitutes the fund available for distribution. (R. 64a) The allowed claims of the remaining creditors of the receiver described in the preceding paragraph exceed the amount of such fund. (R. 64a, 65a) Holders of mortgage bonds of the railroad and its equity securities will receive nothing since the estate is insolvent as to the receivers' creditors alone.

By a series of orders entered during the course of the receivership, the District Court authorized the receiver to issue and sell certificates of indebtedness,

hereinafter referred to as the "certificates", until at August 1, 1910, there had been issued and were outstanding certificates in the aggregate face amount of $3,100,000.00 (R. 1a, 2a). Substantially all of the proceeds of such certificates were, pursuant to orders of the District Court, expended by the receiver for capital improvements, equipment, rehabilitation of the railroad and similar capital items (R. 6b) without which, as the Appellate Division of the Supreme Court of New York in *Weaver v. Pacific Improvement Company,* 198 App. Div. 825, 191 N. Y. Supp. 3, said "the road could not have been kept running".

Thereafter, by a series of refunding and reissue orders, the aggregate face amount of the issued and outstanding certificates was reduced until a final order entered June 16, 1927, brought the amount of the outstanding certificates down to its present size of $2,044,350. (R. 3a, 65a) Of these, $112,290 in principal amount are held as a part of the receivership estate (R. 65a), and the balance of $1,932,060 in principal face amount is publicly held. (id.)

The orders authorizing the various issues, refundings, and reissue of the certificates and the orders authorizing operation of the railroad and mines contained no express provisions with respect to relative priorities in case of liquidation as between claims based on ownership of the receivers' certificates and claims for payment of operating expenses incurred by the receivers.

The typical form of the orders in which the successive receivers were authorized to incur and pay expenses of operation was as follows:

"ORDERED, that out of the funds from time to time coming into his hands *from the operation of the said railroad,* the said receiver shall pay the necessary current expenses of operating the mortgaged property and premises, and executing the trust hereby vested in him, including all taxes and assessments upon the said property." (Emphasis supplied) (R. 16b)

The typical language used in the orders authorizing the issue, refund and reissue of certificates is in relevant part as follows:

"* * * said certificates and each of them shall be a debt by said Receiver for the benefit, protection and preservation of the mortgaged properties of the said defendants and of the creditors and holders of the stock and bonds of said defendant Railroad Company and shall be a lien upon said mortgaged properties, railroads and franchises, coal lands, mining rights and mining plants, and the net income, receipts and profits thereof, prior to the lien of said mortgages or deeds of trust, or any of them, theretofore created under said properties, and shall be recognized as such in any reorganization of said defendants; and in case of any sale of said mortgaged properties, by judicial procedure or otherwise, said certificates, principal and interest, and each of them, shall be paid from the moneys arising from such sale prior to any payment on account of said mortgages or deeds of trust, or any of them, unless sooner paid and cancelled by said Receiver, and said certificates, and each of them, shall be and remain a lien upon said mortgaged properties prior to the lien of said mortgages or deeds of trust or

any of them, until the amount thereof, principal and interest, shall be fully paid; * * *" (R. 17a, 24a, 26a, 27a)

By the terms of the orders of the District Court authorizing their issuance, the certificates now outstanding bore interest at the rate of 6% per annum, payable June 1 and December 1, and became due and payable June 1, 1929. (R. 45a-48a) Such certificates were not paid at maturity although interest thereon was paid until 1932. No interest has been paid on them since December 1, 1932.

On November 29, 1945, the District Court entered its order removing the then receiver, John D. Dickson, as receiver, and appointing successor receivers. (R. 3a) In conducting the operation of the railroad, Dickson had incurred, as receiver, various debts for operating expenses, such as for merchandise, supplies, freight, car service and other railroad charges which had not been paid at the time of his removal as receiver and were not paid by his successors. (R. 64a-74a) Such unpaid operating expense claims aggregate $269,541.22, all of which have been allowed. (R. 66a-71a) Claims were filed by public holders of certificates having a principal face amount of $1,832,020. (R. 65a) Such claims included claims for unpaid interest which had been accrued on such certificates since December 1, 1932, in the annual amount of $109,921.20. Holders of certificates having an aggregate principal amount of $100,040 failed to file claims thereon. (R. 79a) The receivers now in office have filed claims on behalf of such unknown holders. (id.) No claim has been or will be filed with respect to certificates in the principal amount of $112,290 which form a part of the receivership estate. All of the claims

filed with respect to the certificates were allowed as to the principal of such certificates but not as to the interest. (R. 75a-79a)

On March 24, 1948, the District Court ordered the allowance of certain claims not here in controversy, as to which exceptions had been filed (R. 62a), and on April 29, 1948, directed the receivers to prepare and file a Schedule of Distribution which should provide (a) for the payment in full, but without interest, of all claims of operating expense creditors of receiver Dickson, (b) for payment of a first dividend of 25% on the principal face amount of the certificates and (c) for the suspension of payment on certain claims. A Schedule of Distribution prepared in accordance with such order was forthwith filed and on May 7, 1948, the District Court entered an order confirming *nisi* such schedule, to become final without further order unless exceptions should be filed thereto. (R. 80a)

Within the time allowed therefor exceptions were filed to the Schedule of Distribution and to the orders of April 29 and May 7, 1948, asserting that the District Court had erred in providing for payment in full of the claims of operating expense creditors in priority to the claims of the certificate holders; in failing to provide for division of the distributable fund pro rata among the certificate holders and the operating expense creditors including, in the case of the certificate holders, the amount of their claims for interest; in failing to allow the claims for accrued and unpaid interest on the certificates and in failing to treat the interest on the certificates in the same manner as the operating expense claims. (R. 81a-88a)

On November 9, 1948, the District Court dismissed such exceptions, affirmed Schedule A of the Schedule of Distribution, which related to payment of expense claims incurred in operation of the railroad in priority to the claims of the certificate holders, and directed that distribution be made in accordance with Schedule A. (R. 89a-90a)

The effect of the District Court's orders authorizing payment in full of the allowed claims of such operating expense creditors was to create a preference for such claims permitting their payment in full and leaving available for distribution to the holders of certificates the balance of the fund which, however, is much less than the principal face amount of the certificates with respect to which claims had been filed and allowed. (R. 64a-65a)

As a result of such orders the operating expense creditors will receive 100 cents for each dollar of the face amount of their respective claims, whereas, the certificate holders will be paid with respect to each dollar of the principal of the certificates not more than 45.431 cents or with respect to the aggregate of the principal amount of and unpaid interest on the certificates not more than 24.425 cents per dollar. If the priority is denied and pro rata distribution ordered the percentage of recovery by both operating expense creditors and the certificate holders will be substantially less than one hundred per centum but will be uniform.

SPECIFICATION OF ERRORS.

The Court of Appeals erred:

1. In holding that the receiver's debts for operating expenses incurred in the operation of the receivership properties were entitled to be paid in full with priority over the receiver's debts which were evidenced by receiver's certificates of indebtedness issued to procure funds found to be necessary to the continued operation of the railroad.

2. In failing to hold that all allowed debts of the receiver, including in the case of receiver's certificates of indebtedness the accrued and unpaid interest thereon, should share pro rata in the fund available for distribution.

3. In failing to allow as a debt of the receiver, entitled to share pro rata with all other debts of the receiver in the fund available for distribution, the unpaid interest accrued since December 1, 1932, on the receiver's certificates, the debts evidenced by such certificates having been allowed as to the principal thereof only.

4. In sanctioning the repudiation by the District Court of the formal written obligations of its receiver which were sold to the public under the District Court's representation of their high priority as to both the principal and interest thereof without disclosure that the District Court might subsequently, in case of inability to pay all of the receiver's debts in full, subordinate such written obligations to other debts of the receiver having no higher rank or equity.

SUMMARY OF ARGUMENT.

The fund available for distribution consists solely of the proceeds of sale of the corpus of the receivership estate. Administrative costs and expenses have been paid therefrom without objection on the part of petitioners. *Qua* such fund the claims on the receiver's certificates and for the receiver's unpaid operating debts were of equal rank.

The lien of the operating debts had first priority on gross income from operations, while the certificates were expressly made a lien, prior to existing mortgages on the corpus and the net income. No provision was made in any order with respect to relative priorities as between the receiver's debts in case the estate should become insolvent as to the receiver's debts alone, presumably because such possibility was not foreseen. While the orders authorizing the incurring of operating debts necessarily implied that the lien of such debts would also take priority over existing *mortgage liens* if the operating income were insufficient to pay the operating debts in full, it was not implied that such operating debts should take priority over the express lien of the receiver's certificates upon the corpus even if the estate became insolvent as to the receiver's debts alone. In such case, all debts of the receiver, except for taxes, should share pro rata under the doctrine of *Union Trust Company of New York v. Illinois Midland Railway Company,* 117 U. S. 434, 6 S. Ct. 809 (1886). While equitable considerations in rare instances may justify deviation from such doctrine, the court below found none.

Therefore, the orders disallowing the accrued interest on the certificates and authorizing payment in full of the operating expenses with priority over the certificates were grossly inequitable, were clearly contrary to the announced rule of this Court, and constituted a flat repudiation of the District Court's self-incurred debts, an exercise of judicial power "not to be sanctioned under any conditions": *Bank of Commerce v. Central Coal & Coke Company,* 115 F. 878 (CCA 8, 1902).

ARGUMENT.

Much of the long history of this receivership is recited in detail in the opinions of the Court of Appeals of New York and the Appellate Division of the Supreme Court of New York in *Central Trust Company of New York v. Pittsburg, Shawmut and Northern Railroad Company,* 174 App. Div. 800, 161 N. Y. Supp. 694; affirmed 220 N. Y. 690, 116 N. E. 1040; 179 App. Div. 60, 168 N. Y. Supp. 702; reversed 223 N. Y. 347, 119 N. E. 565; 189 App. Div. 921, 178 N. Y. Supp. 882; appeal dismissed 229 N. Y. 68, 128 N. E. 114; *Smith v. Pacific Improvement Company,* 104 N. Y. Misc. 481, 172 N. Y. Supp. 65, and *Weaver v. Pacific Improvement Company et al.,* 198 App. Div. 825, 191 N. Y. Supp. 3, 541, affirmed 234 N. Y. 418, 138 N. E. 42. Examination of such opinions by this Court should be of substantial value in appraising the problem presented in the case at bar.

The receiver was authorized to operate the railroad in the public interest and to pay the expenses of such operation out of the income resulting therefrom. The effect of orders of such kind is well established. The

expenses so incurred are entitled to payment out of such income in priority to the holders of existing mortgages who might otherwise be entitled to such income and, in case of a deficiency in such income, to displace existing mortgage liens: *Finletter, Law of Bankruptcy Reorganizations* (1939 Ed.), pp. 207 *et seq.; Glenn on Liquidation,* Section 572; *Fosdick v. Schall,* 99 U. S. 235, 25 L. Ed. 39.

The receiver was also from time to time during the course of the receivership expressly authorized to borrow money on receiver's certificates of indebtedness for capital expenditures found to be necessary for the continued operation of the railroad. Such certificates were, as is permissible in the case of railroad receiverships, given an express first lien on the net income from operations and on the corpus of the estate itself, with priority over the existing mortgage liens: *id.*

The receivership court in the case at bar did not in any of the orders authorizing operation of the line or authorizing issuance and sale of receiver's certificates of indebtedness deal with the question of relative priorities in case the income from operations should not meet the expenses of such operation and the proceeds of liquidation of the corpus of the estate should not be sufficient to satisfy all receiver's debts having priority over the mortgages, presumably because this unhappy circumstance was not foreseen.

The courts below when faced, at the conclusion of the receivership, with the fact that there was a deficiency in income and that the fund available for distribution, which had resulted solely from sale of the corpus of the estate, was less than the aggregate of the receiver's

debts, had the problem of determining, in the absence of any prior order dealing with the subject, whether there should be any relative priorities as between the receiver's operating debts and the receiver's debts represented by the certificates, the former having an implied lien on the corpus prior to the mortgages and the latter an express lien on the corpus prior to the mortgages. The obviously proper distribution of the proceeds of sale of the corpus under such circumstances would have been a pro rata division on the basis of the total amount of all of the receiver's debts. This would have been the normal result of application of the equitable maxim that "equality is equity" and in accord with the established doctrine in such circumstances laid down by this Court in *Union Trust Company of New York v. Illinois Midland Railway Company,* 117 U. S. 434, 6 S. Ct. 809.

The courts below, however, disregarded not only these guide posts for decision but also the express lien of the certificates on the corpus in holding that there should not be pro rata distribution but that the operating debts should first be paid in full out of the fund, thus displacing the express lien of the certificates on the corpus.

Precisely the same question as in the case at bar was before this Court in the *Illinois Midland* case, *supra.* In that case the railroad system was not complete at the inception of the receivership. Several portions of the lines which were already subject to existing mortgages were unfinished and to be usable had to be completed and equipped. This was authorized by the receivership court which, in order to obtain the necessary funds, caused several series of receiver's certificates to

be issued and sold, each separate series being declared to be a lien upon the particular portion of the road to be completed with the proceeds of such series with priority over the existing mortgages on such portion. After completion of the consolidated system and operation for several years, the court ordered liquidation and distribution of the proceeds. The decree expressly reserved for future determination by the court all questions which might arise in the event that any of the roads forming the consolidated system should fail to produce on sale an amount in excess of the liens of the receiver's debts having priority over existing mortgages on such road.

Various appeals were taken in one of which the certificate holders assigned the above-described reservation as error and claimed that their certificates should be granted priority over all other debts incurred by the receiver in the operation of the system.

This Court sustained such appeal in part, holding that if there should be a deficiency all of the receiver's debts, except those for taxes as to which priority would be allowed, should share pro rata in the fund regardless of the terms of any previous orders. With respect to this, this Court said (6 S. Ct., pp. 834-5):

> "* * * By each of the orders of June 29, 1881, each certificate to be issued under it was declared to be a special charge and lien on the line and property in respect of which it should be issued, superior in lien to all mortgage bonds, and debts of the company, and receiver's debts, except such receiver's debts as had theretofore been declared by order of court to be special charges and liens on such line and property. We are of opinion that (with the

exception of debts for taxes, and receiver's certificates issued to borrow money to pay taxes or to discharge tax liens) there should be no priority or preference among the debts and claims, whether receiver's certificates or other debts, which are allowed precedence over the mortgage bonds of any road, but that all should stand alike, notwithstanding any orders heretofore made, and that the decree should so provide.

"It results that the decrees are reversed * * * so far as they fail to provide that there shall be no priority or preference (with the exception above stated) among the debts and claims, whether receiver's certificates or other debts, which are allowed precedence over the mortgage bonds of any road; and the causes are remanded to the circuit court, with a direction to make those modifications in the decrees; and in all other respects the decrees are affirmed. * * *"

The rule, therefore, in all cases where the receivership court is unable to pay all of its receiver's debts in full is this: When it is established that the receiver's debts cannot be paid in full out of the fund available for distribution the receivership court, in the absence of special equitable considerations, may not establish relative priorities among such debts, except debts for taxes, but must apply the equitable maxim that "equality is equity" and direct payment of all such debts, except debts for taxes, pro rata out of the fund available for distribution.

For an example of a case where equitable circumstances were held to justify modification of this prin-

ciple, see *Reconstruction Finance Corporation v. Missouri, Kansas, Texas Railroad Company,* 122 F. 2d 326 (CCA 8, 1941). In such case the claim of an employee of the receiver for damages for loss of both of his legs sustained in an accident in the course of his employment was given priority over other operating expenses and receiver's certificates because otherwise such employee would not have been paid in full for his injuries. The operating expenses and receiver's certificates with the exception of a small number of the latter, were held to be entitled to share pro rata in the fund for distribution which was substantially less than the total of the receiver's debts. Certain of the certificates, which were purchased on original issue with knowledge that the proceeds would be applied to satisfy six-months' claims, were subordinated to the other certificates and operating expenses on the theory that the receivership court was entitled to differentiate between classes of six-months' claims since it had complete discretion as to whether it would give preference to any six-months' claims and hence, since the proceeds of some of the certificates were with the acquiescence of the purchaser applied to a purpose for which no preference was allowed, such certificates should be given no higher status than the debts which their proceeds satified. It should be noted, however, that with the described exceptions the receiver's debts, whether for operating expenses or on certificates, shared pro rata in the fund.

Anderson v. Condict, 93 F. 349 (CCA 7, 1889), is not at variance with the *Illinois Midland* rule, *supra.* In such case the order authorizing the receiver's certificates expressly provided that the lien of such certificates was subordinate to the other expenses of the receiver. Hence, the purchasers of the certificates took them with

notice of the expense priority and could not complain when their security was diminished as a result of such priority. It may well have appeared to the court that it would have been unable to obtain operating credit if the order authorizing operations had not given priority to the operating expenses.

The *Illinois Midland* doctrine was expressly followed in *First National Bank of Houston v. Ewing*, 103 F. 168 (CCA 5, 1900). In that case the proceeds of liquidation were insufficient to pay all of the receiver's debts. A holder of operating expense claims (wages for labor performed) asserted that his claims should have priority over other operating expense claims and claims on receiver's certificates. Such contention was denied and it was held that all receiver's debts having priority over the mortgages should share alike in the fund.

In *Ball v. Improved Property Holding Co.*, 247 F. 645 (CCA 2, 1917), the facts were quite similar to the case at bar. The dispute as to the division of the fund for distribution was between the holders of receiver's certificates and the lessors of the leased premises which were the subject matter of the receivership, the lessors claiming rentals accrued on the premises during the receivership. The previous orders established no relative priorities as between these claims. Judge Learned Hand held that the claims should share pro rata, saying (247 F. 650-1):

> "[2] As in all such cases, the order authorizing the debt is the most conclusive evidence of the rank which the creditors should hold among other claims on the fund. This has been repeatedly used as the test in cases of receivers' certificates. An-

derson v. Condict, 93 Fed. 349, 35 C.C.A. 335; In re John W. Farley Co., 227 Fed. 378, 142 C.C.A. 74; St. Louis Union Trust Co. v. Texas So. Ry. Co., 59 Tex. Civ. App. 157, 126 S. W. 297; Lewis v. Linden Steel Co., 183 Pa. 248, 38 Atl. 606; In re J. B. & J. M. Cornell (D.C.) 201 Fed. 381. The court having the fund in its custody may establish such priorities as it sees fit, at least as against such creditors, as take the credit of the receiver after the order authorizing the earlier debt had once been passed. Every one who deals with a receiver knows that he has the power to charge his estate only as the court may authorize him, and, if a prospective creditor fails to inquire how far the assets may be already incumbered, he takes the risk.

"[3] We do not forget that the court is not absolutely bound to recognize the priorities fixed by the order, and that the matter is open to equitable readjustment, however conclusive a protection it may be to the receiver as to payments made under its terms. Louisville Ry. Co. v. Wilson, 138 U. S. 501, 506, 11 Sup. Ct. 405, 34 L. Ed. 1023. But, as we shall show, the orders in this case established no priorities as between the classes, and we are therefore relieved of the necessity of determining in what circumstances we should disregard them. All we need assert is that, disregarding the orders, there is no inherent ground for priority between him who lends money to pay accrued rent which is secured and him who allows the use of his property upon the agreement that the accruing rent shall be paid. Just why it should be taken against the lessor that he thought it profitable to leave the property at the

existing rent, or against the bondholders that they should have thought it profitable to assume the lease, does not appear obvious to us. We therefore proceed to consider the effect of the orders.

"[4, 5] The order of November 27, 1912, did not profess to give the certificates any priority except as against the mortgagees and the unsecured creditors. We pass the question whether those words were necessary in any event to give that priority if the order was granted after the mortgagees had become parties to the suit by asking to foreclose. Whether necessary or not, they meant to go no further in establishing priority than to put the certificates ahead of creditors, secured and unsecured, of the corporation. As between themselves and other creditors of the receiver the certificate holders stood, so far as we can see, on a parity for the reasons given above. Hence it follows that the rule should apply of Lewis v. Linden Steel Co., 183 Pa. 248, 38 Atl. 606, and In re J. B. & J. M. Cornell (D. C.) 201 Fed. 381, that the creditors of a receiver in the absence of some original marshaling to the contrary, or of some fundamental equity, shall share ratably. Therefore the fund should be brought in hotchpot with all claims of the receiver, and each should share pro rata. * * *"

In its opinion the Court of Appeals below referred to the fact that some 35% of the original certificates of indebtedness were retired out of net income and that some $1,000,000 of net income was devoted to improving the physical properties of the railroad. It may be that by such reference the Court of Appeals intended to call attention to special equities justifying payment of

the receiver's operating expenses in priority to the receiver's certificates. We submit that such use of income did not create any special equity of a kind which would justify a receivership court in repudiating its formal obligations.

The lien of the certificates expressly extended to the net income and, when such net income existed, it was with the formal approval of the receivership court applied to payment in part of the certificates and to necessary improvement of the properties from which the operating income was derived. Such dedication completely eliminated such net income from the subsequent scope of operation of the prior right to the income from operations afforded to operating expense creditors. The natural tendency of such dedication of net income was to maintain or increase subsequent operating income.

Furthermore, such use of net income is of no concern to the operating expense creditors here claiming priority. The claims of the present operating expense creditors arose during the administration of John D. Dickson as receiver, whose term of administration extended from December, 1923 to November, 1945. The dedication of net income to retirement of certificates and making of capital improvements took place prior to July 3, 1917 (R. 6b). Obviously any extensions of credit made after 1917, as they were by the operating expense creditors at bar, were made with notice of the orders appropriating such income to such described purposes and that such net income would not thereafter be available to defray operating expenses. The creditors in the case at bar can only have extended credit at a time

when they either knew or were bound to know that their sole security was the subsequently accruing income of the receivership estate plus the implicit right to share equally with other creditors of the receiver if, upon liquidation, the receivership estate should prove insufficient to pay all receiver's debts in full.

We submit that the courts below found no special equity existed which justified their repudiation of the self-incurred debts of the receivership court and in fact no special equity could have been found because none existed.

The court below appears to have confused diversion of income to the benefit of mortgagees, which is at the bottom of the rule permitting displacement of mortgage liens by the receiver's operating expense creditors in cases of such diversion, with use of net income by the court itself to pay its own debts and to enable continued operation of the railroad. These cases are completely unlike and not comparable in any respect.

The refusal of the courts below to direct payment of the certificates according to their tenor cannot be too severely criticized. The certificates were sold to the public backed by the most formal representations of the receivership court itself as to the high priority of their lien for both principal and interest.

When unable to pay their own debts in full receivership courts have the power to modify existing priorities but may do so only within the strict confines of equitable principles. We submit that in the case at bar the modification ordered was a gross abuse of such judicial power

and went far beyond the limits within which modification could equitably be made since it fully displaced the express lien of the certificates for the benefit of debts due creditors of the receiver whose claims had no express lien on the corpus of the estate. We do not contend that the receiver's operating debts should have been subordinated to the receiver's debts on the certificates but we do assert that all of the receiver's debts, including the receiver's debt for unpaid interest on the certificates, should have been held entitled to share pro rata in the fund.

Disallowance of the accrued and unpaid interest on the certificates was an abuse of judicial power of the worst sort and should never be countenanced. In the *Illinois Midland Railway Company* case, *supra,* this Court, with respect to the contention that interest on receiver's certificates should not be allowed, said (6 S. Ct. at p. 824):

> "It was also contended before the commissioner that all that the holders of these certificates were equitably entitled to was the money they paid, and without interest, and not the face of the certificates and interest. The view taken by the Commissioner, and confirmed by the circuit court, was that, as the certificates were issued for debts contracted by the court, when it had jurisdiction of the parties and of the subject-matter, to persons who in good faith invested their money, for the benefit of the property in the possession of the court, the certificates should be paid according to their tenor, as authorized. * * *"

In *Bank of Commerce v. Central Coal & Coke Company*, 115 F. 878 (1902), the Circuit Court of Appeals for the Eighth Circuit pointedly observed (115 F. at p. 880):

"* * * The obligations of the railroad company to pay its debts is not affected by the receivership and foreclosure. It retains its corporate existence, and its creditors may still pursue it, and in some cases its officers and stockholders. But it is not so with the debts contracted by the court. They are not debts of the railroad company, and the company is not liable for them. The court alone is liable for its debts. That obligation imposes on the court the duty to apply the property or its proceeds in its custody and control to the payment of the debts contracted by it in and about the management of the property. *Judicial repudiation of obligations is not to be sanctioned under any conditions.* One of the chief duties of courts of justice is to compel delinquent debtors to pay their debts. It could do this with poor grace indeed if it neglected to pay its own debts when it had the means to do so. It is true that the errors and mistakes of courts, though they may ruin a citizen, are placed in the category of injuries produced by the law, and for which the law furnishes no redress. But here the court has committed no error or mistake, and has it in its power to protect its contracts and its credit, and do justice to the citizens who trusted it. *While a court cannot be adjudged a bankrupt, and no proceedings can be taken against it to enforce payment of its obligations, these very facts make it all the more important that it should scrupulously observe its obligations to the citizen.* A court that would fail to

do this would speedily and justly forfeit the respect and confidence of the public. * * *" (Emphasis supplied)

The usual insolvency rule that where claims of the same rank exceed the fund for distribution no interest may be allowed on such claims, is pertinent here only to the extent that it would prevent interest from accruing on the operating claims and on the unpaid interest on the certificates. The interest on the certificates was expressly accorded equal rank with the principal thereof by the orders of the receivership court authorizing issuance and being due as a matter of right, i.e., having been contracted for by the receiver under express orders of the receivership court, disallowance of such interest and the preference granted to the operating expense creditors constituted a serious abuse of the court's duty to honor its own obligations. Furthermore, we submit, equity courts do not have discretion in the allowance of interest where interest is recoverable as a matter of right under the express order of court creating the indebtedness.

"Whether or not claims arising out of dealings with the receiver will bear interest is determined in accordance with the order of the court out of which the claim arises": *Tardy's, Smith on Receivers* (2d ed.) vol. II, sec. 598.

It is obvious that the accrued interest on the receiver's certificates was just as much a cost of operation of the railroad as, for example, the claim of The American National Red Cross for rentals on a line leased to the receiver. "Interest bears the same relation to money as rent does to land * * * Rent is compensation for the use of land or property, while interest is a sum paid for the use of money": *47 C. J. S.* sec 1 (p. 11).

The receiver had for many years the use of funds belonging to the certificate holders. Certainly if the receivership court is justified in allowing compensation for the use by the receiver of a line or railroad belonging to a third party it is obligated to pay interest on the funds which its receiver borrowed and used in connection with the operation of the estate.

We submit that the action of the courts below in repudiating the self-incurred obligations of the receivership court is a gross abuse of judicial power and flagrant violation of the established public policy that courts shall deal fairly and equitably with their own creditors. The keystone of administration by courts of equity of estates of insolvent debtors is the equitable maxim that "equality is equity". To approve the action of the courts below in this case, in discriminating among the debts of their own receiver, would bring into serious question the integrity of the judicial administration of insolvent estates.

For the reasons hereinabove stated, we submit that this application should be granted, the orders of the courts below reversed and such courts be directed to modify their orders in accordance with the principles stated in *Union Trust Company of New York v. Illinois Midland Railway Company, supra.*

Respectfully submitted,

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IN THE

Supreme Court of the United States

NO. 498 OCTOBER TERM, 1949.

CENTRAL TRUST COMPANY OF NEW YORK, Plaintiff,

v.

THE PITTSBURG, SHAWMUT AND NORTHERN RAILROAD COMPANY, SHAWMUT MINING COMPANY, THE KERSEY MINING COMPANY and HAMILTON TRUST COMPANY, Defendants.

ROBERT WOMSLEY, CHARLES A. WOODS, JR., and KENNETH BALLENTYNE, Constituting a Committee for the Protection of Holders of Certificates of Indebtedness of the Receiver of The Pittsburg, Shawmut and Northern Railroad Company and the Mortgaged Properties of the Shawmut Mining Company and The Kersey Mining Company; HUGO E. SELLGER; EDWARD L. BLACKMAN and PFLUGFELDER, BAMPTON & RUST, a Partnership, Individual Holders of Some of Such Certificates, Petitioners.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI.

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BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI.

STATEMENT OF THE CASE.

Petitioners' statement of the case is incomplete, particularly in that they do not mention the fact that the receivership, which began on August 1, 1905, pertained not only to the debtor railroad but also to the mortgaged properties of two affiliated mining companies, Shawmut Mining Company and The Kersey Mining Company, and the fact that the order authorizing the receiver to pay the necessary current expenses of operating the mortgaged properties and premises out of the funds from time to time coming into the receiver's hands from the operation of the debtor railroad (petitioners' brief, p. 5)

was made on August 1, 1905, at the time of the appointment of the receiver. The order authorizing payment of the necessary current expenses was made before any certificates of indebtedness of the receiver had been authorized, issued or sold.

The series of orders made between August 25, 1905, and June 29, 1910, authorizing the receiver to issue certificates in the aggregate amount of $3,100,000 did not provide that such certificates were to be issued in order "to raise funds necessary to keep the railroad in operation" (petitioners' brief, p. 3) but, on the contrary, the orders provided that the certificates were to be issued and sold and the proceeds thereof were to be used for various capital expenditures and improvements to the railroad and the mining properties (10a, 13a, 14a, 16a, 17a). The court orders authorizing the issuance of the certificates only granted to the certificates a lien upon the receivership properties and "the net income, receipts and profits thereof, prior to the lien of the said mortgages or deeds of trust, or any of them," theretofore created upon the receivership properties, and in case of any judicial sale of the properties the "certificates, principal and interest, and each of them", were to be paid "from moneys arising from such sale prior to any payment on account of said mortgages or deeds of trust, or any of them".

The receiver, beginning sometime shortly after August 25, 1905, and ending sometime prior to July 3, 1917, expended the $3,000,000 realized from the sale of the certificates, together with an additional sum of about $1,000,000 taken from the net earnings of the mortgaged properties, for additions and betterments to the mortgaged railroad and mining properties (6b).

After June 29, 1910, the court did not authorize the issuance of any new certificates except for the purpose of taking up those outstanding as they fell due. The subsequent orders authorizing the refunding certificates did not alter the lien provision of the prior orders (35a). The reduction of the aggregate amount of outstanding certificates from $3,100,000 to $2,044,350 was the result of the court orders of February 29, 1924, and June 16, 1927, which respectively authorized the retirement of 30% and 5% of the outstanding certificates by means of a pro rata payment thereon from accumulated funds of the receivership properties and the exchange of new certificates for the unpaid residue of the old certificates (46a, 48a, 65a; petitioners' brief, p. 4).

The original receiver, Frank Sullivan Smith, and his successor receivers, Henry S. Hastings, John D. Dickson, and Thomas C. Buchanan and Robert C. Sproul, Jr., operated the railroad and the mortgaged properties of the two affiliated mining companies from August 1, 1905, to the date of the judicial sale of the receivership property in the spring of 1947. At the time of the hearing on August 28, 1947, before the district judge, all operating expenses had been paid from 1905 to 1942; most of the operating expenses had been paid from 1942 to December 1, 1945; and all operating expenses had been paid from December 1, 1945, to the date of the cessation of the operation of the railroad in the spring of 1947. From August 25, 1905, to the time of the hearing on August 28, 1947, no holder of certificates, including the petitioners, had ever objected to the payment of the operating expenses. At the hearing on August 28, 1947, petitioners, though they had not theretofore objected to any payment of operating expenses of the receiver, immediately ob-

jected to the receivers' proposal for payment in full of the unpaid operating expenses which had accrued from 1942 to December 1, 1945. Petitioners frankly admitted, by their counsel, while asserting the objection to the payment of the unpaid operating expenses, that there was no distinction between the unpaid operating expenses and expenses which had accrued before and after them and that they could give no valid reason for distinguishing the unpaid from the paid operating expenses except their arbitrary decision to object to the one but not to the other category of operating expenses. The following colloquy took place between the judge and petitioners' counsel at the hearing on August 28, 1947, (21b, 22b):

> "*The Court*: Let me ask you, is it true, as Mr. Goodman said, they are paid, but I was going to say what about the current obligations incurred by Mr. Sproul and Mr. Buchanan as against your group? Of course, there aren't any current obligations since they have been paid. Do you make any claim as to any irregularity on the part of the Trustees in paying current obligations?
>
> *Mr. Eckels*: No, your Honor, we do not. The position may be inconsistent, but we do not object to the payments that they have made to their own creditors.
>
> *The Court*: How do the current obligations that they incurred differ any from Mr. Dickson's?
>
> *Mr. Eckels*: Your Honor, there is no substantial difference, in my opinion, except we have not objected to them and we don't intend to object to them.

The Court: What is your position?

Mr. Eckels: Our position is only with respect to the claims of Mr. Dickson's creditors, that at the very worst, the Receivers' Certificates and the operating expenses of Mr. Dickson are on a parity.

The Court: How do Mr. Dickson's obligations differ from Mr. Sproul's and Mr. Buchanan's?

Mr. Eckels: Your Honor, I do not think they differ at all, but we are not objecting to the payment of them."

Certain of the operating expense creditors of the debtor railroad have joined in filing this brief. The Baltimore and Ohio Railroad Company filed a claim which has been allowed in the amount of $29,353.84 for operating expenses of the receiver of the railroad from July, 1945, until December 1, 1945, and $25,148.65 of this amount arose from interline freight balances. The Erie Railroad Company filed a claim which has been allowed in the amount of $25,207.02 for operating expenses incurred between August 1, 1945, and December 1, 1945, and $22,943.09 of this amount represents freight interchange collected by the receiver and not paid over to the Erie Railroad. The Pennsylvania Railroad Company filed a claim which was allowed in the amount of $109,375.72, incurred between May 1, 1945, and December 1, 1945, and $96,625.25 of this amount represents interline freight and interchange. The American National Red Cross filed a claim in the amount of $26,386.59, for amounts due under two leases of railroad right of way and adjoining property for the years 1942 through 1947. The claim of The American National Red Cross was reduced by agreement to $20,000.00 (18b) and $10,000.00 of the claim was allocated to the period of the receiver-

ship of Messrs. Buchanan and Sproul (20b). The remaining $10,000.00 of the Red Cross claim was allocated to the period of the receivership of Mr. Dickson (20b). The claim of the Red Cross for the period of Mr. Dickson's receivership which is now before this Court includes New York taxes in the amount of $6,582.57, the payment of which was essential if the receivers were to comply with the terms of the sale of the property (19b) whose proceeds are being distributed. As part of the agreement arrived at between The American National Red Cross and the receivers the Red Cross agreed to pay the New York taxes if its claim was allowed in the sum of $20,000.00. The receivers, following this agreement, paid to the Red Cross the sum of $10,000.00, representing the portion of the claim allocated to the period of the receivership of Messrs. Buchanan and Sproul (21b).

The Court will notice that although there are 96 holders of certificates who have filed claims with the receiver (75a-79a), and originally 37 of them excepted to the order of distribution (81a, 85a), the petitioners to this Court, objecting to the full payment of the operating expenses, are only three, holding 19.9 per cent of the total amount of outstanding certificates (75a, 76a). These petitioners upon their appeal from the order of the district court filed a bond on appeal in the sum of $250 (5a) and were not willing to file a bond in an amount sufficient to obtain an order of supersedeas.

SUMMARY OF ARGUMENT.

There is no conflict between the decision of the courts below and the decision of this Court in *Union Trust Co. v. Illinois Midland Ry. Co.*, 117 U. S. 434, or of the Court of Appeals for the Fifth Circuit in *First National Bank of Houston v. Ewing*, 103 Fed. 168, or of the Court of Appeals for the Eighth Circuit in *Reconstruction Finance Corp. v. Missouri-Kansas-Texas R.R. Co.*, 122 F. 2d 326.

There is no question of public importance or general interest involved in this case.

The courts below were correct in their decision on the merits of the controversy.

The claims of railroad operating expense creditors of the receiver are entitled to priority of payment over the receiver's certificates, since the certificates were issued for capital expenditures and improvements to the railroad and mining properties. It is manifest that the court, in the orders authorizing the issuance of the receiver's certificates, granted to those certificates a lien of priority only over the pre-existing mortgages or deeds of trust or any of them and did not grant such certificates any priority over railroad operating expense creditors. The court's order now appealed from, authorizing payment in full of the railroad operating expenses with priority over the certificates, principal and interest, far from being "grossly inequitable" and "a flat repudiation of the District Court's self-incurred debts, an exercise of judicial power 'not to be sanctioned under any conditions' " (petitioner's brief, p. 11), was a proper determination, in accordance with established princi-

ples, of the relative rights of the railroad operating expense creditors and the certificate holders.

The continued operation of the railroad depended upon the freedom of the receiver to incur and provide for the expenses of operation, and such continued operation was not only for the protection and benefit of the public but also for the protection and benefit of the interests of the certificate holders. Had the receiver been unable to operate the railroad at any time, a judicial sale would have been forced when the price realized for the receivership property might not have been available.

The courts below properly refused to come to the conclusion, since it was not compelled by the language of the orders authorizing the issuance of the certificates and the conditions under which they were made, that the receivership court from August 25, 1905, to June 29, 1910, intended to fetter and indeed to render wholly impossible the continued operation of the debtor railroad in the future by imposing upon themselves and the receiver an impotence to make acceptable provision for the necessary future expenses of operation.

Since the proceeds of the certificates in this case were expended wholly for capital improvements and betterments not only to the railroad but also to the two affiliated mining companies, the certificate holders are not entitled to stand on a parity with the railroad operating expense creditors.

Certiorari should therefore be denied.

ARGUMENT.

The priority of receiver's certificates is fixed by the terms of the court orders authorizing their issuance.

In *Reconstruction Finance Corporation v. Missouri-Kansas-Texas R.R. Co.*, 122 F. 2d 326 (C.C.A. 8, 1941), the court said (p. 330):

> "Any priority, however, which it was intended at the time that they [receiver's certificates of indebtedness] were to have over subsequent operating expenses should have been clearly indicated in the court orders which authorized their issuance."

The court orders authorizing the issuance of receiver's certificates in the instant case provided no priority over subsequent operating expenses. The certificates were "a debt by said Receiver * * * and * * * a lien upon said mortgaged property, railroads and franchises, coal lands, mining rights and mining plants, and the net income, receipts and profits thereof, prior to the lien of said mortgages or deeds of trust * * *" (7a).

The court, at the time when it made these orders, clearly contemplated, as is manifest from the portion of the order of August 1, 1905, authorizing the receiver to continue operation of the properties and to pay the necessary current expenses of operation thereof, that the operations of the railroad should be continued and paid for. The certificates are made a lien upon the *net* income, receipts and profits of the properties. There can be no *net* income until the expenses of operation are paid. The only priority granted the certificates by these orders is over the existing mortgages and deeds of trust.

In the *Missouri-Kansas-Texas* case, *supra*, the certificates were given a much broader priority. They were (p. 330)

> "* * * a direct lien upon all the property and franchises, wherever located, of the Fort Smith and Western Railway Company * * * and upon the net income thereof, prior and paramount to the * * * mortgages or deeds of trust, * * * *and prior and paramount to all other liabilities and obligations of every kind, character and nature of said Fort Smith and Western Railway Company.*" (Italics added.)

In spite of this all-inclusive priority provision, the Court of Appeals for the Eighth Circuit held that operating expenses and receiver's certificates whose proceeds had been used for operating expenses should be given priority over receiver's certificates whose proceeds had not been used for operating expenses. The court said (p. 331):

> "The receiver's operation of the railroad was not in the interest of creditors and stockholders alone, but equally for the purpose of attempting to preserve the service to the public, to which the railroad of necessity was dedicated. No one could say how long the effort to serve the public interest through receivership operation ought justifiably to be continued. In this situation, the conclusion ought not to be indulged, unless inexorably compelled by the language of the order and the conditions under which it was made, that the court was intending to fetter and perhaps render wholly impossible the continued operation of the railroad, by an impotence to make acceptable provision for nec-

essary future expenses. Certainly such a conclusion is not soundly required here. We think the trial court properly held that the orders authorizing the receiver's certificates were intended to create a priority only over existing liens and obligations of the railway company, and that the matter of the receiver's future operating expenses was left entirely open. Indeed, even if an attempt had been made to create an absolute and complete priority in the issuance of the receiver's certificates, this would not, generally speaking, have precluded the court from subsequently making an equitable readjustment, with respect to the necessary expenses of continuing the operation of the railroad in the public interest."

To the same effect is *Anderson v. Condict,* 93 Fed. 349 (C.C.A. 7, 1899), where the court said (p. 353):

"It is not presumable that the court would devest itself of the power to pay the expense of operation which it had assumed. That would be an act of felo de se. It granted to the certificates a lien paramount to that of the trust deed, subject, however, to the payment of operating expenses and costs of administration; and this, we think, comprehends all liability incurred in the operation of the railway."

Rental for the use of leased tracks and terminals, as in the case of the property of The American National Red Cross here involved, was allowed as an operating expense with the same priority as pertained to other operating expenses in *Union Trust Co. v. Illinois Midland Ry. Co.,* 117 U.S. 434. This Court said, by Mr. Justice Blatchford (p. 467):

"'And it seems to me that the rentals for the use of the leased lines were incurred as much for the common benefit as were the expenses for employes and supplies along the line. If the management of the road had been so profitable as to have left a net income to apply on the mortgage debt, the Paris and Decatur bondholders would have been entitled to their proportionate share of the income derived from the use of the leased lines; they could scarcely have expected that without contributing to the payment for the use of those lines.' These views apply equally to the terminal facilities furnished by the leasing roads."

See also *Mercantile Trust Co. v. Farmers' Loan & Trust Co.*, 81 Fed. 254, 258 (C.C.A. 8, 1897).

In the case at bar the proceeds of the receiver's certificates were not expended on operations but on capital improvements and betterments to the railroad and to the properties of the mining companies. To the extent that the certificates represent investments in the mining properties, they are obviously not of the same quality as the railroad operating expenses of the receiver and are not entitled to share in distribution on a parity with those railroad operating expenses. To the extent that they represent capital improvements to the railroad properties, they are also subordinate to the railroad operating expenses, as has been held in many instances.

In *Texas Co. v. International & G. N. Ry. Co.*, 237 Fed. 921 (C.C.A. 5, 1916), certiorari denied *sub nom. Central Trust Co. v. Texas Co.*, 243 U.S. 647, the court authorized receiver's certificates in the amount of $1,400,000 and gave them a prior lien upon the mort-

gaged property and all other property in the possession of the receivers and upon the net earnings and income resulting from operations. The proceeds of the certificates were used for the erection of shops, the acquisition of passenger equipment and the ballasting of the tracks. The court held (p. 937) that these expenditures were not expenses of operation, and that one who furnished labor and supplies to the receiver for the operation of the railroad was entitled to be paid ahead of the receiver's certificates.

A similar case is *First National Bank of Houston v. Ewing,* 103 Fed. 168 (C.C.A. 5, 1900), certiorari denied 179 U.S. 686, in which the receiver had been authorized to issue certificates of indebtedness and to expend the proceeds on capital improvements almost identical with those in this case. After the sale of the railroad by the receiver, there were not sufficient funds to pay the operating expenses and receiver's certificates in full. The court gave certain operating expenses priority over the holders of the receiver's certificates. The operating expenses thus given priority are of the same nature as those of the respondent railroads, namely, traffic balances owing to connecting railroads and right of way claims (103 Fed. 168, 173).

The decision in *Reconstruction Finance Corp. v. Missouri-Kansas-Texas R. R. Co.,* 122 F. 2d 326 (C.C.A. 8, 1941), emphasizes the fact that operating expenses are entitled to priority of payment over all other expenses of the receiver except costs of administration and taxes. There the court allowed receiver's certificates whose proceeds had been used for operating expenses to share pro rata with operating expense claims, but subordinated the receiver's certificates whose

proceeds had been used for other expenses. This is made particularly clear in the unreported opinion of the District Court for the Western District of Arkansas, copies of which were furnished by petitioners to the courts below. The opinion of the district court in that case supports the position of respondents and not that of petitioners. The court said (p. 15):

> "Aside from these two items, so far as the orders disclose, all of the money procured from the Reconstruction Finance Corporation (the holder of the receiver's certificates) went for operating expenses of the Receiver of the Fort Smith and Western Railway Company."

Accordingly, the court concluded (p. 17):

> "The Court is of the opinion that the amount of the claim of the Reconstruction Finance Corporation should be allowed *as an operating expense,* except the amount which the court has specifically held was incurred prior to the receivership on June 1, 1931." (Italics added.)

The *Missouri-Kansas-Texas* case holds that if the proceeds of the receiver's certificates are used for operating expenses, the certificates are entitled to prorate with operating expenses, but if the proceeds are used for other purposes, they may not prorate with operating expenses. As was said in *Fidelity Insurance & Safe Deposit Co. v. Shenandoah Iron Co.,* 42 Fed. 372, 377 (W.D. Va., 1889), receiver's certificates, being merely evidences of indebtedness, have no higher priority than the claims which they represent.

The decision of this Court in *Union Trust Co. v. Illinois Midland Ry. Co.,* 117 U.S. 434, is authority in

support of the decision of the courts below in the case at bar. The position of the petitioners in this case is analogous to the position of the bondholders in that case. There the bondholders were to receive in distribution the balance of the proceeds of judicial sale remaining after the payment of the preferred costs and expenses of the receivership, and in this case the certificate holders, under the order of the lower court, are to receive the balance of the proceeds of the judicial sale after payment of the operating expense claims. There the proceeds of the sale were not sufficient for the entire payment of the receivership costs and expenses and the claims of the bondholders, and here the proceeds are not sufficient for the entire payment of the operating expense claims and the certificate holders' claims. The equity of the bondholders of the Pittsburg, Shawmut and Northern Railroad was eliminated long ago and the only lienholders with any equity in this railroad are the certificate holders. The petitioners in this case, in the position of the bondholders in the *Illinois Midland* case, here assert the very same contentions which were there pressed by the bondholders. There the bondholders complained of a provision in the final decree which gave priority over their bonds to the following items: wages due employees of the receivers, indebtedness due from the receivership to railroad companies, general indebtedness of the receivership for supplies, damages and miscellaneous items and several other claims (p. 464). The operating expense claims granted priority in the case at bar are claims of employees of the receiver, indebtedness due from the receivership to railroad companies on account of freight interchange, car service and other railroad charges, general indebtedness of the receivership for supplies, rentals for leased trackage

and terminals, and like items (66a). This Court in the *Illinois Midland* case granted priority for exactly the same kinds of claims as those of the respondents here not only out of the income of the road but from the proceeds of the sale of the receivership property itself. The certificate holders here were in the same position as the bondholders in that case; that is, they had furnished funds for capital expenditures and improvements to the receivership properties. After the issuance of the receiver's certificates and the creation of their lien, the respondents here extended credit to the receivers by letting the receivers use their property, their credit for the payment of taxes and their services as connecting carriers, just as the receiver's certificate holders in the *Illinois Midland* case allowed the receiver there to use their services and their credit in exchange for receiver's certificates. In each case it is the *nature* of the claim of the operating expense creditors rather than its form which requires the grant of priority to such creditors.

This Court in the *Illinois Midland* case, recognized that where current income is diverted to the improvement of the receivership property and debts for operating expenses are not paid, provision should be made to pay such operating expense debts out of the proceeds of the sale of the property. The Court said, by Mr. Justice Blatchford (pp. 462-463):

> "The commissioner and the Circuit Court rested the allowance of these certificates on what was said by this court in the case of *Fosdick v. Schall,* 99 U.S. 235, 253, 254, which views were applied in *Burnham v. Bowen,* 111 U.S. 776, to the effect that, when the current income of a railroad in the hands of a receiver is diverted to the improvement of the prop-

erty by the receiver, and debts for operating expenses are not paid, provision should be made, in foreclosing a mortgage on the road, to pay such debts out of the proceeds of the sale of the property. See, also, *Union Trust Co. v. Souther,* 107 U.S. 591."

It was also contended in the *Illinois Midland* case by the bondholders, as it is contended in the case at bar by the certificate holders, that though certain debts had been admittedly incurred by the receiver in the regular operation of the railroad, such claims were entitled to priority only out of the income of the railroad and not out of the proceeds of the property. This Court, in rejecting the contention and holding that such claims were entitled to priority out of the proceeds of the property as well as the income therefrom, said (pp. 464-465):

"As to items (1) (2) (3) (4) and (5), while it is admitted that these debts were incurred for the ordinary expenses of the receivers in operating the road, it is contended that they are entitled to priority only out of the income of the road, and not out of the proceeds of the property itself. Of course, such items are payable out of income, if any, before the *corpus* is resorted to, but that may be resorted to when the items are proper ones to be allowed for operating expenses, after scrutiny and opportunity for those opposing to be heard. This view is in accordance with the principles above laid down and the authorities above cited.

"It is contended, however, that, in the order of September 11, 1875, appointing Dole receiver, while authority was given to him to carry on the business of the road, and to make repairs and additions essential to its interests and safety, it was provided,

that, out of the moneys he should receive from its operation, he should pay for the expenses of operation; that he was not authorized by that order to contract any debt which the receipts of the road would not pay; that the terms of the order were such as to exclude the payment of any of the expenses embraced in the six items above named out of any fund other than the receipts from the operation of the road; and that the orders appointing Rees and Genis were equally limited. But we think this view is not correct. The terms of these orders do not impair or exclude the ample authority which the court would otherwise have, and otherwise has, to order the claims in question to be paid out of the property itself, with priority."

There is, as is indicated in the *Illinois Midland* case, another compelling reason why the operating expenses should be preferred over the receiver's certificates. This Court and other federal courts have held, in railroad receiverships, that where there is a diversion of the income derived from the receiver's operation to the payment of capital expenditures, persons having claims for operating expenses are entitled to priority of payment out of the corpus of the receivership estate to the extent of the diversion. This is on the theory that the income produced by operations must first be applied to the payment of the expenses of the operations. *Fosdick v. Schall*, 99 U.S. 235, 253-254; *Texas Co. v. International & G. N. Ry. Co., supra.*

Thus in *Clark v. Central R.R. & Banking Co.*, 66 Fed. 803 (C.C.A. 5, 1895), affirmed 170 U.S. 355, it was held that one who furnished coal to the railroad for its op-

eration both shortly before and during receivership was entitled to priority of payment out of the corpus of the estate over claims for expenditures for permanent improvements to the railroad where the receiver's income had been diverted to pay the expenditures for the improvements. See also *Gregg v. Mercantile Trust Co.*, 109 Fed. 220 (C.C.A. 6, 1901), affirmed 197 U.S. 183.

In the case at bar the receiver expended some $4,000,000 for additions and betterments to the railroad and mining properties, of which about $3,000,000 was derived from the receiver's certificates, and about $1,000,000 was taken from the net earnings of the properties (6b). In addition to this diversion of $1,000,000 of operating income, under the orders of February 29, 1924, and June 16, 1927, the receiver expended $1,038,500 for the retirement of outstanding receiver's certificates (46a, 48a, 65a; petitioners' brief, p. 4). Since the proceeds of the certificates had been used for capital expenditures, as petitioners admit, the retirement of the certificates out of the operating earnings of the receivership constituted a diversion of the earnings to capital expenditures. We have, therefore, a situation in which more than $2,000,000 of the net earnings of the railroad in receivership have been diverted to capital expenditures. Under the authority of the above cited cases, the operating expense creditors are entitled, to this extent, to receive priority of payment over the receiver's certificates out of the corpus of the receivership estate. Since the operating claims involved in this appeal amount to only $259,477.24, it is clear that they should be paid in full before any sum is allocated to the payment of the receiver's certificates.

Petitioners argue that, regardless of strict legal principles, they are equitably entitled to be treated equally with operating expense creditors—they furnished money on credit to the receiver, the operating expense creditors furnished services and supplies on credit to the receiver. An analysis of the facts shows, however, that there is nothing to recommend this argument to the consideration of a court of equity. The claims of the respondent railroads arose in most part from freight interchange. It would seem obvious that had the receiver done what he was obligated to do and paid over to the connecting lines the funds thus coming into his hands, the appellants would have had no valid grounds for objection. It would seem equally clear that the connecting lines were not relying on the general credit of the receivership and extending credit to the receiver in this respect but that they were put by the receiver in a position in which any action on their part to enforce their rights would, if successful, have resulted in the termination of the operation of the railroad, as would any action on their part to terminate most of their other relations with the railroad which gave rise to the other portion of their claims. Moreover, any attempt by the connecting lines to change regulations and practices which governed their relation with the Pittsburg, Shawmut and Northern Railroad would have necessitated proceedings before the Interstate Commerce Commission (Act of Feb. 4, 1887, c. 104, Sec. 15, 24 Stat. 384, as amended, 49 U.S.C.A., Sec. 15) and would probably have resulted in a Commission order suspending these new regulations and practices.

As to a large portion of the operating expense claim filed by The American National Red Cross, the amount

claimed is for taxes which the receiver was obligated to pay under the terms of the leases and which constituted liens not only upon the leased property in the State of New York, but also upon the whole of the receivership property located in certain municipal subdivisions of the State of New York. In order to comply with the terms of sale it was necessary for the receivers to see that these liens were satisfied to assure that the purchaser of the receivership property secured the title he was paying for. The claim of the Red Cross to the extent that it represents payment of taxes that the receiver was obligated to pay should be given the same priority in payment that would have been given the tax claims themselves.

Petitioners, as well as other holders of certificates, are estopped because of their acquiescence and the acquiescence of their predecessors to raise any question now as to the propriety of the preferred payments to operating expense creditors. Over the long period of this receivership they knowingly stood by while the receiver paid in full his operating expenses and failed in due time, by some proper proceeding, to question the validity of his conduct. Counsel for petitioners frankly admits that there is no distinction between the operating expenses involved in this appeal and those which accrued before and after them (*ante,* pp. 4-5). This Court in *Union Trust Co. v. Illinois Midland Ry. Co.,* 117 U.S. 434, held that parties who so acquiesce and fail by proper proceeding to question the validity of an arrangement are estopped to raise any question relative to such arrangement upon proceedings for the distribution of the receivership property. In that case an arrangement was effected to establish a continuous line from Peoria, Illi-

nois, via Decatur to Terre Haute, Indiana, to be operated under a common management, and the bondholders of the Paris and Decatur Railroad and their trustee permitted the court and the receiver to go on during the entire litigation contracting debts in respect to the whole line as a unit and administering the property as one. When the estate was about to be sold and distributed these bondholders for the first time questioned the validity of the arrangement. This Court, in that connection, said (pp. 468-469):

> "Independently of this, it is entirely sufficient to rest our conclusion on the principle that nonaction on the part of the Paris and Decatur bondholders and their trustee * * * amounts to such acquiescence as should operate as an estoppel."

As a matter of fact, the operation of the railroad was, as found by the courts below, for the benefit of the certificate holders. The certificates, like the mortgage bonds, are a lien upon the properties and franchises of the railroad. The continued operation of the railroad preserved these properties as a going concern and prevented the forfeiture of the railroad's franchises and the consequent collapse of the mining enterprises; thus it preserved the security of the certificate holders and was for their benefit. By reason of the continued operations, the receivers were not forced to sacrifice the receivership properties but were able to make a judicial sale of them at a most opportune time. Courts have long recognized the equity of giving such operating expenses priority over lienholders whose security is thereby preserved. *Miltenberger v. Logansport, Crawfordsville and Southwestern Ry. Co.*, 106 U.S. 286, 310; *Union Trust Co. v. Illinois Midland Ry. Co.*, 117 U.S. 434, 456; *Gregg v. Mercantile Trust Co.*, 109 Fed. 220, 222 (C.C.A. 6,

1901), affirmed 197 U.S. 183; *Central Trust Co. v. Chicago, A. & N. Ry. Co.*, 232 Fed. 936 (N.D. Iowa, 1916).

Patently the decision of the courts below is not in conflict with the decision of this Court in *Union Trust Co. v. Illinois Midland Ry. Co.*, 117 U.S. 434, or of the the Court of Appeals for the Fifth Circuit in *First National Bank of Houston v. Ewing*, 103 Fed. 168, or of the Court of Appeals for the Eighth Circuit in *Reconstruction Finance Corp. v. Missouri-Kansas-Texas R. R. Co.*, 122 F. 2d 326, but, on the contrary, is fully in accord with those decisions.

No question of public importance or general interest is involved in this case. The case at bar only involves the private rights of 96 holders of receiver's certificates actively asserted by only 3 petitioners, holding 19.9% of the total amount of outstanding certificates, and the rights of 143 operating expense creditors.

Accordingly, the decision should not be reviewed, since there is no need to direct any modification of the order of the lower court. There is nothing in this case that justifies the granting of a writ of certiorari.

Respectfully submitted,

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